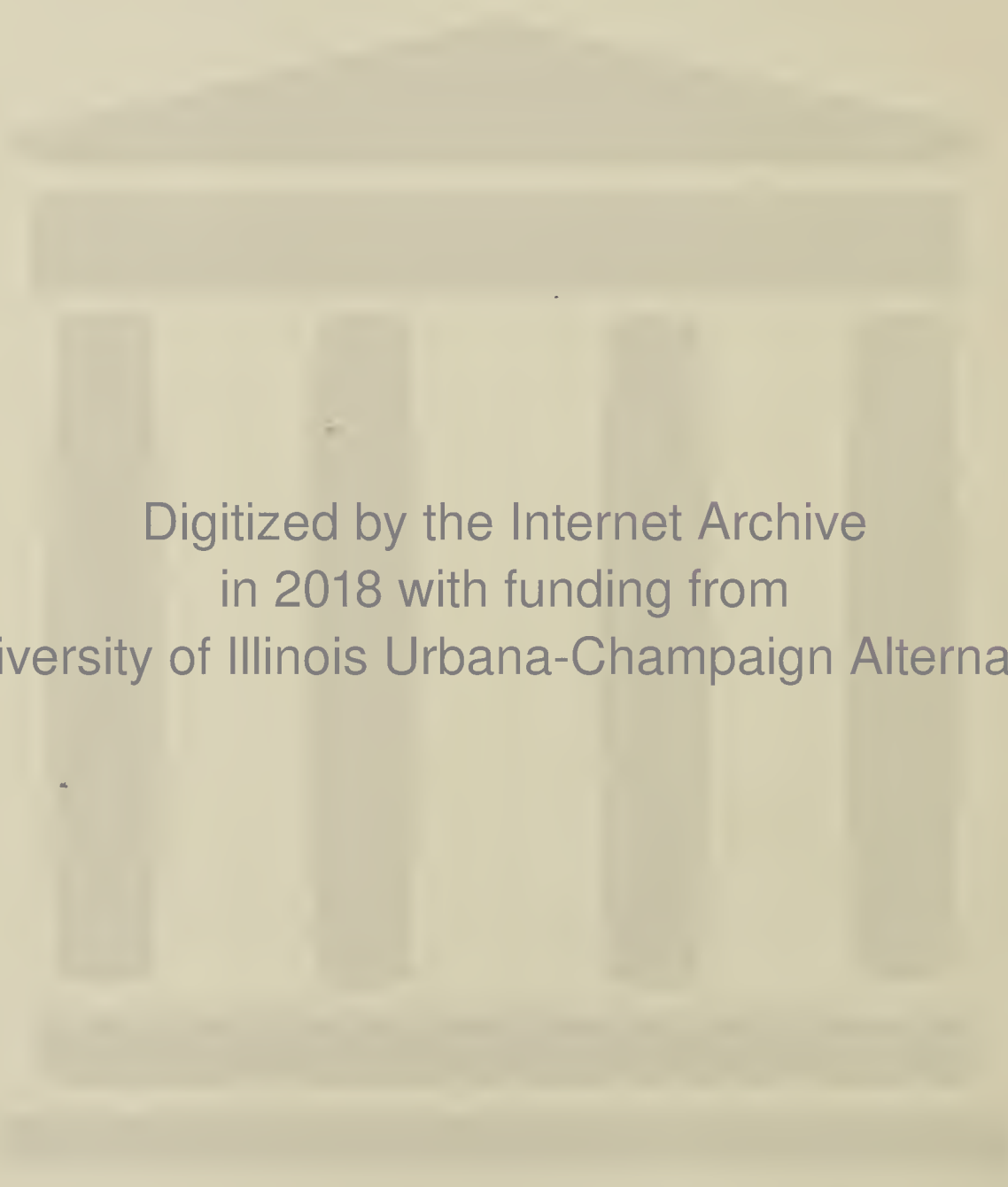


Clearing Houses
and Currency

No. 1



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ECONOMICS
DEPARTMENT

CLEARING HOUSES AND CURRENCY

No. 1

BY

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kindred nature, operating on broad and liberal lines, are deserving of the undivided support of all classes of citizens. I am glad to have the opportunity to congratulate you on the evidence of the friendly spirit you have shown here to-night, and I trust that the material welfare and commercial standing of your city will always be your first thought.

I am going to speak to you this evening on the subject of Clearing Houses. Very little attention has ever been paid to these institutions outside of the immediate banking circles which have been connected with them, but latterly more attention has been given to their facilities and there has been a growing feeling on the part of the business interests that they can be utilized along broader lines in helping to solve our currency problem.

The Clearing House has become a powerful factor in the financial life of this country. From small beginnings, used simply as a device for exchanging checks between banks, it has become a great machine through the combination of banks in each association for upholding and strengthening the integrity of our financial institutions; and as its members have seen from time to time what can be accomplished through

its agency they have delegated to it more and more powers; and whatever may be said as to the exercise of these powers, it still behooves us to stop and consider how far such powers can continue to be delegated to these various associations without becoming oppressive to the banks which are its members.

A general discussion of these powers has been brought before the business community at the present time, largely on account of the activity of the so-called Pujo Committee, and it has been suggested by this Committee that these associations should be incorporated. Opinion seems to be divided among the bankers of the country as to the wisdom of this move. I have for a long time, after careful study of the situation, felt that they should be incorporated, and in an address delivered at Columbia University, shortly after the panic of 1907, I suggested the incorporation of Clearing Houses, and in my testimony before the Pujo Committee I also favored such incorporation. It has seemed to me that if Clearing Houses are ever to form the nucleus of a comprehensive currency system, in this country, as some of us believe to be possible, one of the first requisites is adequate provision for their incorporation.

As we all know, public sentiment has changed very decidedly during the past ten years with respect to matters of this character, and during the past decade all of our public service corporations have been carefully supervised by public service commissions and our railroads by the Interstate Commerce Commission, and I think it is the consensus of opinion that this has been for the public good. It is now becoming the order of the day that when any body of men exercise power which affects the public at large, or any great portion of the public, that power or authority, although ostensibly private, is nevertheless impressed with public character, and, therefore, should be subject to governmental regulation, irrespective of the manner in which it may have been administered in the past, and as this seems to be the generally accepted status of affairs in the United States to-day, I am sure the Clearing Houses of this country sooner or later will of necessity be obliged to recognize it and either submit to incorporation under a general law of the Federal Government or become incorporated under various State laws. When incorporated they can be held responsible for their acts and be subject to such provisions as the law may delegate to them.

I do not believe the extent to which many

associations have carried their rules and regulations along lines which, to say the least, are very restrictive among their members in doing business, is generally known. In one large city in Pennsylvania, rules are enforced which prohibit the solicitation of accounts of other members, and members having depositors of other member banks shall have the right to ascertain from such members the extent and character of loans made to such depositors, and when a depositor applies to one member bank, that bank shall have the right to ascertain from the depositor's bank whether a loan has previously been offered there and refused, and the reason for its refusal. In this way the depositor would actually be barred from closing his account with one bank and going with another.

In one large southern city very stringent rules have been made with reference to the banks of the association allowing rebates of interest on loans paid before maturity, and a fixed rate is established which must be strictly adhered to in such case. This is done in several Clearing Houses of the country.

In many Clearing Houses they have rules covering the methods of advertising of the different banks, and in one large city all printed adver-

tising by the members is restricted to daily newspapers and to circulars intended for distribution. And in another city the Clearing House has an advertising committee to which is referred all contracts for advertising by members.

In a Pennsylvania city the associated banks report to each other the names of persons whose accounts have been closed, due to overdrawing or for any other reason, and the president or cashier, on the day the account is closed, sends a slip containing the names and addresses to all the other banks in the city. This provision is in force in several of our large Clearing House Associations.

In a large western city every bank member of the association compels its depositors to sign an agreement that they will not hold the bank responsible for any check cashed or deposited until the returns are fully received.

In another large western city a daily meeting of the committee is held to fix the buying rate for exchange received from customers in amounts of \$10,000 and upward.

In a large southern city no member of the association, or bank or trust company clearing through a member, can accept on deposit or

for collection from local customers items drawn against local banks or trust companies not members of the association, thus barring out all competition.

In several cities rules and regulations are established which prohibit the giving away of check books, and the rates which the banks must charge for the same are carefully supervised.

In thirty-one cities, mostly large, the regulation rate of interest that shall be paid on deposits is fixed by the Clearing House Association, and in several cities the rates of interest that shall be charged upon loans by the associated banks are fixed. The Clearing House Association appoints a committee who from time to time names the minimum rate.

One large Clearing House Association in the West was the recipient of special attention by the Pujo Committee, in its recent investigation, practically all of its active officers having been subjected to rigorous examination upon its rule that members should not be permitted to pay interest on checking accounts, except those already on their books, which was believed to be directed against a new bank. The bank in question refused to subscribe to the new rul-

ing, claiming it would hamper its growth, and being uncertain of their power to enforce expulsion, the other members withdrew and formed a new association.

Among the other notable Clearing House regulations are the fixing of the premium or discount to be paid or received on exchange, regulating the cost of transfers by wire, and in most cities the Clearing House defines the minimum amount of capital and surplus a bank must have to be eligible for membership.

And last, but not least, in ninety-one cities the Clearing Houses have established rates for the collection of out-of-town checks and the fixing of penalties for the non-compliance with such rates.

Many other associations have established rules and regulations in regard to Clearing House examiners.

I could go on for some time, but I do not desire to weary you by giving details as to the methods which are being pursued by some of the two hundred and thirty associations in this country. I have taken the liberty of citing only a few examples of what is being done by Clearing House Associations so that you may see that there is some foundation for the sug-

gestion that these associations should be incorporated and made responsible for their acts.

While there is a large field for expansion in the activities of Clearing Houses, and while it may be that in some of the instances I have cited this expansion has been beneficial, nevertheless, in other cases in which the associations have gone to great lengths in the regulation of the business of their members, this represents an abuse of the Clearing House system. The point I seek to make is that these and other extensions of Clearing House activities, whether good or bad in themselves, involve a dangerous exercise of power, unless the whole system is brought under proper governmental regulation. By the undue exercise of power, many of the associations have undoubtedly laid themselves open to criticism. They will probably have to relinquish a good many of these regulations in the event of the Government establishing, as I sincerely trust it will, a Federal Incorporation Law for Clearing Houses.

For some time I have been of the opinion that all banks should be admitted to membership in the associations, irrespective of the size of their capital, provided their management and loaning system were sound, and there is

no good reason why small institutions, as well as large, should not have the facilities of the Clearing House. It is also a source of great expense to all banking institutions to collect checks and drafts on outside banks, not members of any given association, and I believe some plan can be formulated which will permit institutions of small capital, but with ample means for the amount of business they do, to become members. Perhaps some scheme for a sliding scale of capital and surplus might be applied so that it will be necessary only for institutions that desire to clear to have a proper amount of capital and surplus in proportion to their deposits.

These and many other matters could be covered by a proper act of incorporation. My own preference, if it could be legally done, would be for a Federal Incorporation Act, something after the order of the National Bank Act. If this could be accomplished, Clearing Houses could, perhaps, classify under the head of Central Reserve and Reserve City Clearing Houses, with powers delegated to each one of these classes. My thought would be to make them come under the jurisdiction of the Secretary of the Treasury, rather than of the Comptroller of the Currency, because of the fact that the mem-

bership of these associations consists of State institutions, as well as institutions incorporated under the National Bank Act.

In most associations the Clearing House Committee, sometimes called the Committee of Management, or Executive Committee, is elected annually and is vested with almost absolute power, the direction, practically, of the whole machinery of the Clearing House resting in its hands. This committee consists of from three to five men, presidents of the strongest institutions of a given city. The personnel is usually changed from year to year, but in most large cities this committee revolves in a few hands; and where Clearing House examiners are employed it is almost impossible for the members of this committee not to know, through this examiner, pretty much the condition, methods, and business of all their competitors. While the men who have composed these committees in the various Clearing Houses of the country for many years have been men of high character and standing, and have exercised the powers conferred upon them in a discreet manner, still I would favor the appointment for life or for a long tenure of office of a paid president of the association in several of the large cities like New

York, Chicago, St. Louis, Boston, Philadelphia and others, who should be a banker of national reputation, and draw a salary equal to that of any bank president. He should not engage in the banking business, but should devote all of his time to the duties of his office. In this way many things could be accomplished which cannot now be done in serving the interests of the members of the association and preserving the integrity and competition of the individual bank.

I am firmly of the belief, and have been for several years, that in the Clearing House Associations of our country we have facilities which can be utilized as a safe basis upon which we may issue currency. In common with many others, I endorsed the so-called Aldrich Bill, but it has become more and more apparent that this bill cannot be enacted into law, and we naturally turn to the next best thing, namely, to utilize the existing machinery of the banking business which has been tried, and see if by careful analysis we cannot, from these present beginnings, which have served us so well, build up a monetary scheme which will serve the people of this country as a whole without respect to location or environment. If the country does not seem ripe for a wholesale turnover in

our monetary system, why not do what is to be done gradually? I believe our present administration has a great opportunity to accomplish a lasting good along this line for the American people.

There is a prejudice of long standing, which, happily, is growing less and less, against our banks, and the people at large are now coming to believe that the bankers of the nation are their friends and not their enemies. This old prejudice was due to the fact that banks formerly charged high rates for the use of money, and kept them at a distance. I think our bankers are beginning to realize that they have been largely at fault in this matter, and they are now taking the people more and more into their confidence in matters of finance. This is the day of the open door in banking, and the business of discounting a customer's note is not held behind closed doors, but the customer now comes to the bank as a matter of right, because of certain obligations to him on the part of the bank. He presents a detailed statement of his affairs to the institution with which he deals, and on the strength of his financial condition revealed therein, and of the balances maintained, he secures from the bank the amount

of accommodation which he himself recognizes as being just and proper according to established standards. The banking business is in this way becoming better known to the public at large, and men are not afraid of committing their affairs to their bank because of their competitors. This is the era of publicity—of competition in trade.

The bankers of this country have been largely to blame for lack of currency reform because they could not, and cannot now, agree among themselves as to the best method to be pursued. The time is ripe, it seems to me, when we should agree upon some simple foundation and then build our system of finances upon it, and that foundation, I believe, we have in the various Clearing House Associations of the country. I feel that an elastic currency, designed to meet the requirements of our trade, can be devised by availing ourselves of the machinery of our Clearing House Associations.

In the panic of 1907, the maximum amount of Clearing House Loan Certificates, Cashier's Checks, and other substitutes for money issued, as far as known—and I have attempted to gather these statistics very carefully—was \$236,189,000 which, after the panic, were all retired

without the loss of a single dollar to the banks or to the public. Of this maximum amount, \$84,420,000 were outstanding in New York; \$38,285,000 in Chicago; \$10,578,000 in St. Louis—a total of \$137,283,000, or 58% of the whole having been contributed by the three present Central Reserve Cities.

The Reserve Cities, forty-seven in number, had a maximum amount of \$88,496,000, or 37½% of the whole; so that the Central Reserve and Reserve Cities issued 95½% of the entire amount of these so-called Emergency Certificates. If we look at it in another form and take simply the Sub-Treasury cities, nine in number, consisting of New York, Baltimore, Cincinnati, Boston, New Orleans, St. Louis, Philadelphia, Chicago, and San Francisco, these cities issued about 78% of the amount outstanding.

I am giving you these figures to show that if the Clearing Houses either of the Central Reserve Cities and Reserve Cities, or simply the Clearing Houses in cities where there are Sub-Treasuries, could be properly incorporated and privileges given to them in connection with the issue of an elastic currency suitable to the trade and commerce of the country, bearing a high

rate of interest while the same was outstanding, and retirable by deposit of lawful money in the Treasury of the United States, the same as National Bank Notes are now retired, we would then have the machinery established for handling an asset currency which would be available in all parts of the country. If these associations could then be federated in some way so that the actual cash reserve which is held in one association would not be drawn out by another association and a scramble for cash be made in times of stress, and by combining them under some governmental supervision and power whereby the reserves of the various associations could be massed, I believe we would have the beginning of a strong financial system in this country. From time to time methods could be evolved for the retirement of National Bank Notes based upon Government bonds and other of the reforms which are so needful could be carried out.

The thought which I have just outlined, in a general way, would create elasticity in the assets of the banks in the various associations. In times of financial stress and special activity, what the banks require are assets which are readily convertible into cash and which will

pay depositors as well as afford a basis for new loans. At such times we need expansion in the right direction, and not contraction. We do not need more fixed currency, but we do need flexibility. In times of panic or extremely tight money, the banks require some means by which they can convert their fixed assets into liquid assets without calling upon borrowers for the payment of their loans, and with these new liquid assets furnish further credit to their customers, because in such times the needs of the occasional, as well as other borrowers upon the banks, are very large.

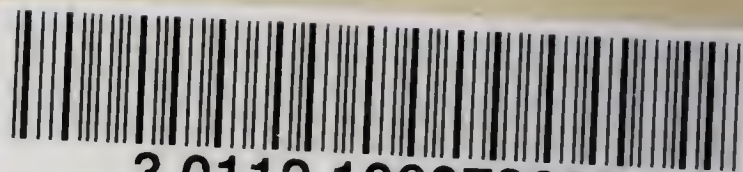
The purpose of the Clearing House Loan Certificates, which were used so extensively in the panic of 1907, was to allow the banks to take to the Clearing House their fixed assets and to convert them into a medium of exchange between themselves, thus allowing the extension of further credit, which credit was utilized by their depositors through the Clearing House.

Panic always produces fright, not only among the public at large, but also among the banks themselves, and if we could have a provision for the issuance of an asset currency, through a modification of the Clearing House system, and properly authorized under Government

supervision, it would go a long way toward allaying the fear which occurs at such periods and would, to a great extent, prevent these periodical disturbances in our financial world.

It is not my desire to appear a pessimist with respect to the immediate future of this great country of ours, but I do feel very strongly that something should be done, and done at once, looking to the reform of our currency. The money markets of the world are very firm, and the demands upon capital for several years are going to be greater than ever before. A large amount of the world's funds have for some time been in the process of conversion into fixed capital, such as railroads, buildings of unprecedented size, public service utilities, the Panama Canal, conservation and irrigation schemes, and other things of like character, not only in this country, but throughout the civilized world. Another feature of the situation is the disturbance of the financial equilibrium which has been brought about by the extraordinary absorption of gold by India. It behooves us, therefore, in view of the large demands for credit which are staring us in the face from all directions, to so adjust our currency conditions in this country that we will be in a position to meet any exigencies that may arise, without disturbing our prosperity, and I earnestly

hope our present administration will see the necessity for promptly finding some solution of our currency problem.



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